



# Performance Perspective

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City of Seattle

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Performance Perspective is a periodic newsletter issued by the Office of City Auditor to highlight general management principles or to disclose successful, useful or problematic program management issues. Please send your comments, suggestions, questions, or concerns regarding these reports to Susan Cohen, City Auditor. Telephone: 233-1093. E-mail: [susan.cohen@ci.seattle.wa.us](mailto:susan.cohen@ci.seattle.wa.us). MS 01-11-01

## Effective Public Private Partnerships

**Public private partnerships are collaborative arrangements between government and the private sector that involve the public partner paying, reimbursing or transferring a public asset to a private partner in return for goods or services.**

Effective public private partnerships allow government to leverage the creativity and efficiency of the private sector to deliver public goods or services. Public private partnerships have been developed to cover a variety of collaborative arrangements between government and the private sector, including arrangements for capital facilities.

The City Auditor's Office conducted a survey of other local government agencies to obtain general information on public private partnership arrangements. One important survey objective was to determine how other jurisdictions gained meaningful and timely citizen input on public private partnerships established for capital development projects. The following summarizes the survey results.

### Other Local Governments Commonly Developed Public Private Partnerships to Finance Capital Projects

Public private partnerships for downtown and neighborhood development were common in other local jurisdictions. While development-related objectives were consistent with the city-adopted comprehensive and community plans, each public private partnership was unique. Frequently, overall mission statements, goals and objectives for public private partnerships were established through comprehensive or downtown development planning processes, rather than through the specific public private partnerships. The following are examples of development projects financed by local jurisdictions, including the City of Seattle, through public private partnerships.

COMMON PUBLIC PRIVATE PARTNERSHIP PROJECTS		
Commercial Office Space	Hotels and Retail Malls	Public Works Facilities
Corrections Facilities	Low/Moderate Income Housing	Sports Arenas and Parking Garages
Entertainment Complexes	Pedestrian Walkways	Historic Preservation Projects
Educational and Medical Facilities	Plazas and Open Space	Waterfront Facilities

As shown above, the projects developed through public private partnership arrangements were varied, and reflected the flexible attitude maintained by local governments to encourage public private partnership arrangements. In fact, local governments generally did not attempt to define or restrict partnership arrangements beyond good government and business practices.

### Public Involvement Mechanisms for Public Private Partnerships Varied from City to City and Project to Project

City of Seattle legislation mandates public involvement in departmental process, and Seattle citizens have been instrumental in recommending improvements to both public and private development project plans and designs for many years. However, public involvement mechanisms for public private partnerships have varied widely in Seattle as well as in other local government agencies.

Public involvement processes ranged from simple legal notices of Council hearings and one or two public hearings to highly elaborate public forums and workshops with citizens advisory committees, blue ribbon panels, technical advisory committees, and more than 25 community meetings and public hearings. Some public involvement procedures were established by local government agencies for a particular partnership arrangement; other citizen participation processes were developed in response to Federal or state mandates. For example, public private housing partnerships funded with U.S. Department of Housing and Urban Development resources are routinely subject to the public notification and hearing requirements pursuant to the Code of Federal Regulations.

Public involvement and planning processes generally require considerable time, such as the recently completed four-year process for the City's neighborhood planning process, and many private partners are unwilling to tie up capital resources for extended periods of time without assurance that a project is likely to be approved. Consequently, most cities adopted flexible public processes to ensure that a balance was achieved in gaining public trust and input while steadily advancing the project. For example, some cities attempted to establish comprehensive, downtown, or neighborhood plans that contained general development goals and priorities in addition to identifying potential locations for future development projects. Proposed development projects, including public private development projects, consistent with the established plans and community goals were often able to streamline the public review periods even though the projects were still subject to local land use and design reviews.

Another local government interested in a substantial downtown mixed-use development worked closely with the community to define the development goals and to establish design guidelines for the project site prior to the solicitation of a private development partner. This effort not only ensured that the developer's proposal would meet the city's objective for a signature mixed-use project but also significantly reduced the developer's risk during the design review and approvals process.

While the public involvement processes in many local governments were frequently as flexible and varied as the partnership arrangements, public notices were most commonly used to inform citizens of pending public private partnerships for new developments, and public hearings were most commonly used to obtain citizen input. In fact, formal Council hearings were the only consistent public involvement mechanisms for all public private partnerships in each surveyed jurisdiction. Some cities held only one Council hearing; other cities routinely scheduled three formal public hearings during the project conceptual, design, and development phases.

One city council held public hearings to introduce the public private partnership concept, and then determined whether sufficient public interest was generated to schedule informal public forums or establish a citizen advisory committee. As a rule of thumb, only formal Council hearings were required for public private development projects that were highly technical (solid waste, water filtration) and/or located in remote areas (airport cargo facilities), because public interest was very limited for these types of projects. Conversely, multiple public meetings and workshops were scheduled prior to formal hearings for substantial development projects located in downtown and neighborhood areas (major retail development) because these projects tended to generate significant public interest. When substantial opportunity for public scrutiny and debate occurred during the conceptual, design and planning processes, formal Council hearings tended to focus on project approval with limited opportunities for public comment during the formal hearings.

Although public notification and involvement processes varied, public agencies generally agreed that an established process was necessary to inform citizens of public private partnerships. In addition, adequate input from neighborhood residents and business associations was considered instrumental to the success of public private partnerships in neighborhoods, particularly for projects that proposed a variety of uses, to ensure that the development was compatible with or advantageous to the surrounding community.

Seattle citizens were highly interested in public private partnerships for the following reasons:

- Many neighborhood groups are acutely focused on public private partnerships as a means to find practical solutions to retaining neighborhoods and business activities.
- Proposed development projects will surface as plans age that were not envisioned in the adopted comprehensive, downtown, or neighborhood plans. Furthermore, given the diverse characteristics of many Seattle neighborhoods, interests are likely to change during the next five to twenty years.
- Some neighborhoods view public private partnerships as a potential means to achieve equity among neighborhoods for new development given the perception that the City may not be

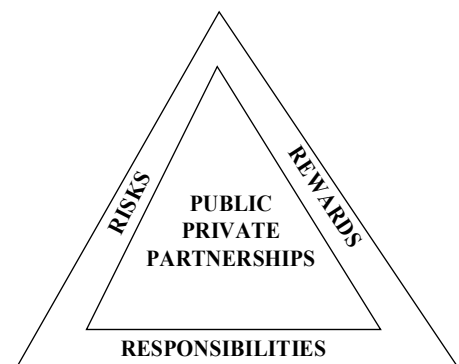
able to allocate resources or opportunities consistently between the downtown and neighborhoods or among the neighborhoods.

- Many citizens choose not to become involved in City processes or project developments until a project directly effects them in what is perceived to be an adverse way. In addition, citizens will criticize the process as well as the project if they perceive that proposed public or private developments will adversely impact their neighborhoods.
- Some Seattle neighborhoods adversely impacted by existing development projects, including public private partnership arrangements, will be particularly sensitive to public processes to ensure that development proposals adequately provide for neighborhood mitigation measures.

Finally, even though public involvement processes were considered highly desirable, both city representatives and citizens expressed interest in developing objective and straightforward participation models for the review of public private development projects. Citizens' interest in a simple process stemmed from the desire to participate effectively in the review of potential partnerships without burdensome time demands. City officials' interest in a straightforward public involvement process stemmed from the concern about potential lost opportunities if the city cannot respond to a proposal from a private partner in a timely manner. In fact, many local government agencies cited examples of projects in which public involvement processes were streamlined to take advantage of unanticipated partnership opportunities.

#### **Public and Private Partners Have Unique Risks, Rewards and Responsibilities for Partnership Projects**

Effective public private partnerships recognize that government and businesses have unique perspectives on the risks, rewards, and responsibilities associated with development projects. Nevertheless, the public partner will ultimately be responsible for the long-term obligations and viability of public facilities and services provided through partnership arrangements and for the protection of taxpayers interests. Consequently, local governments and citizens have a shared interest in ensuring the viability of proposed public private partnerships.



Despite different local government and business perspectives on the risks and responsibilities for partnership projects, public laws and burdensome policies (e.g., contracting procedures) are frequently waived in an effort to expedite public private partnership arrangements. Consequently, the financial, legal, and operational aspects of a proposed public private partnership need to be scrutinized rigorously on behalf of taxpayers to ensure that the project is viable and public objectives can be achieved. (Please see information below on specific types of partnership risks.) This does not mean that citizens need to be directly involved in the project review. In fact, many local governments, including the City of Seattle, have turned to outside experts to ensure that both public and private partnership objectives can be achieved. However, the partnership issues must be appropriately addressed so that the public can be reasonably assured that their interests are protected.

It should be noted that competition and risk are essential components of public private partnerships as are the prospective benefits to the public of high quality facilities (or services) attractive

prices. In fact, the economic success of most partnerships for local government clearly rests on healthy competition among the *private* partners. Those partnerships in which two *public* partners competed for the business of a private partner have been financially disastrous. Therefore, it is important that the City's public private partnership policy address the neighborhoods' interests and roles in a manner that discourages internal competition for private partnerships.

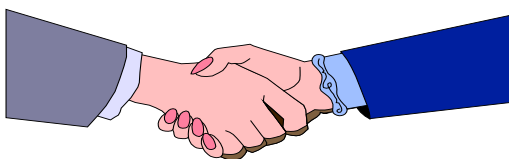
Finally, one objective of the public private partnership survey was to identify public disclosure requirements established by other State and local jurisdictions for prospective private partners. We found that all local governments routinely requested substantial financial information from the private partners to demonstrate their ability to successfully complete the proposed project and that the joint project was economically viable. All public private partnership agreements were also subject to public disclosure, including the financial arrangements and guarantees. However, the private partner's financial portfolio was not disclosed to the public in any of the jurisdictions surveyed.

**Recommendations:** Based on our review above, we recommend that the City of Seattle:

1. **Identify** the major elements of public private partnership projects and develop review criteria that ensure that the City and public objectives are adequately addressed, particularly the legal, environmental, financial, design, and political issues.
2. **Develop** streamlined procedures for notifying the public about proposed partnerships. Consideration should also be given to routinely posting information regarding proposed partnerships on the City's web site. Information should include the nature of the public private partnership, primary objectives, the private partners, City resources committed to the project, and the significant benefits and risks associated with the project.
3. **Develop** public involvement procedures that balance the City's requirements for citizen input on proposed public private partnerships with the private partners' interest in timely investment of private resources. Ample opportunity for public review and comment should be provided at formal Council hearings, especially if earlier public meetings were not scheduled.
4. **Encourage** open competition among prospective partners whenever possible (e.g., requests for proposals) to maximize the economic benefits of the partnership arrangement, and discourage competitive arrangements with other local governments and among City neighborhoods.
5. **Develop** a policy to ensure that the financial information required from the prospective partners is protected, with the exception of financial information that directly pertains to specific public private partnership agreements.

### **The Heart of a Sound Public Private Partnership**

In forming public private partnerships, both the public and private organizations agree to identify, allocate and share the risks associated with the partnership arrangement. Ideally, the contract terms and conditions specific to the public private partnership apportion an equitable distribution of the financial risks and benefits to both partners, and the public partner substantially reduces its risk by maintaining the ability to monitor contractor performance against City objectives.



### **Inherent Public Private Partnership Risks**

The following information, extracted and condensed from studies, audits and our survey of public private partnerships in other local government agencies, highlights the different perceptions of public and private developers that lead to common risks in partnership arrangements.

#### **Inherent Risks for Private Partners**

- The prospect of profits motivates private partners to risk their own resources on the delivery of public services or capital investments.
- Private partners time investments to maximize profits given the prevailing market conditions.
- Private partners seek to limit disclosure of sensitive financial information or prospective plans.

### **Inherent Risks for Public Partners**

- Hidden pitfalls and high price tags for the public partner.
- Waiver of protective but burdensome public finance laws and procurement policies and procedures.
- Eroding benefits (of competition) without contract safeguards to limit the public partner's financial risk.
- Undue criticism of public partners if private partners earn extraordinary profits commensurate with their level of risk.
- Weak negotiating leverage may result in an insurmountable negotiating and financial advantage for the private partner.

### **Examples of Private Partner Selection Risks**

- Selection of private partner without competition or competition among public partners.
- Public partner's excessive reliance on or favored treatment of a private partner that forecloses the possibility of fair competition.
- Subsequent contracts that are negotiated on a sole-source basis may result in non-competitive prices.
- Excessive reliance on the private partner to clarify public services objectives.
- Partnerships negotiated behind closed doors are often perceived as just old-fashioned favoritism.

### **Examples of Contractual Risks**

- Contract terms assigned a disproportionate share of the risks to the public partner.
- Accepted proposal contained "no-risk financial plan" and "guarantees" not stipulated in the contract.
- Contract contained vague and contradictory language, and provided the private partner with leverage to change services that increased project costs.
- Contract scope was vague, open-ended, and depended on evolving events, decisions and actions.
- The public partner lacked the capacity to monitor the contract, and turned over administrative control to private partner that was also responsible for other related project work.
- Schedule pressures and high political stakes create strong incentives for public partners to resolve disagreements promptly and to pay whatever was necessary to keep the projects on track.
- Project costs were difficult to predict and control unless compensation was tied to results and deliverables rather than level of effort.
- Public partner paid significantly more than the amount specified in contract for the same level of service specified in the contract.

- Higher financing costs than those for general obligation financing.

### **Lessons Learned from Unfavorable Bargains**

- Protecting the public interest means early detection and assessment to reduce the public partner's potential risks.
- Scrutinizing the fine print of the partnership agreements and verifying claims of successful partnering arrangements with other jurisdictions.
- Public partner walked away from sales pitch that camouflaged the actual costs and risks of the partnership arrangement.
- Taxpayer's interest were protected by developing a partnership agreement that required the private partner to pay the fair market value of the property.
- Formal contract contained strict provisions to ensure that the public would have reasonable access to and use of "donated" property.

### **Steps Toward Successful Public Private Partnerships**

Clarify the public objectives of partnership arrangements and ensure that they are specified in the partnership agreement.

- Identify financial exposure and negotiate contract safeguards and invest in the necessary expertise. Without the requisite expertise to negotiate effective contract safeguards, a public partner will not be a match for the sophisticated expertise on the other side of the table.
- Design a careful, competitive (if possible) selection process. Non-competitive selections or policy environments generally cancel out the advantages of competition, and competition will not be an effective safeguard if replacing the private partner is not perceived as a realistic options.
- Set and enforce contractual performance standards. Maintain adequate administrative control to reduce the risks of cost escalation, inadequate performance, etc.
- Be prepared to walk away when red flags signal trouble ahead. Private firms will ensure that their interests are protected and public agencies have an obligation to do the same.

#### **Public Private Partnership Task Force**

In late 1998, the Mayor and City Council President appointed a Public Private Partnership Task Force to develop a proposed public private partnership model, including mechanisms for citizen and neighborhood review and input into future public private partnerships. The task force will present its report in September 1999.

For a related report, see [Citizen Participation in the Public Process](#).

Other recently released reports from the Office of City Auditor:

- Seattle City Light, Skagit Project and Skagit General Store Financial Performance Audits
- Commute Trip Reduction Program
- Rehabilitation and Emergency Assistance for City Homeowners (REACH) Program
- City of Seattle's Pension Systems and Deferred Compensation Plan Program Audits

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